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Canada: Near-Normal Growth Prospects

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CANADA: NEAR-NORMAL GROWTH PROSPECTS

1. Canada will have one of the best economic performance records among the developed countries in 1974. If economic policy is moderately expansionary, as seems likely, real GNP probably will rise by 4% - 4-1/2%. Canadian economic growth thus promises to match growth in France and Japan and to contrast sharply with the stagnation or decline anticipated in the United States, West Germany, the United Kingdom, and Italy.

2. The main task of Ottawa's economic policy is to compensate for weakened demand for Canadian goods in such important markets as the United States, Japan, and the United Kingdom. Since there is little excess capacity in most industries, moderately stimulative measures probably will push the inflation rate above last year's 9% and cut the trade surplus to perhaps $1 billion, compared with $1.9 billion in 1973. Moreover, with a 4% - 4-1/2% growth rate -- down from the long-term average of 5-1/2% -- Canadian unemployment can be expected to increase appreciably. Under these circumstances, it is questionable whether a good record of economic growth in a difficult year actually will broaden popular support for Trudeau's minority government.

Recent Developments

3. With the recovery of industrial production from the third-quarter strike disruptions, real GNP growth hit an annual rate of about 7-1/2% in the fourth quarter. Consumer demand remained buoyant, and private investment outlays rose sharply. Demand was especially strong for machinery and equipment; orders reached new highs. Meanwhile, some shortages developed as capacity utilization in manufacturing nearly recovered to the high of 97% reached early in the year. Arab restrictions on oil shipments to eastern Canada had little effect on output, being offset by shipments from Canada's western oil fields.

4. Despite strains on productive capacity, the inflation rate subsided in the last quarter, in contrast to the accelerating rates experienced in other developed countries. The improvement was less the result of slower growth in the money supply than of a slower rise in food prices as domestic supplies increased. Canadian inflation continued to stem mainly from excess domestic demand and rising world prices for raw materials – a trend felt domestically, even though Canada is a major exporter of such goods. The Trudeau government did little to combat inflation because of its preoccupation with economic growth and employment. Rather than curb price increases, Ottawa cushioned their impact by raising welfare payments and subsidizing the production of consumer items such as bread.

5. The oil crisis caused foreign demand for Canadian goods to weaken more than was previously anticipated as a result of the general cyclical downturn. Since import demand remained strong, the global trade surplus fell to $390 million in the fourth quarter, compared with $590 million a year earlier, and the balance with the United States shifted from the usual surplus to a $60 million deficit. The current account deficit remained small, and continuing long-term capital inflows gave Canada a small surplus in its basic balance.

Prospects for 1974

6. Ottawa already has signaled its intent to stimulate demand by proposing an 11% increase in government spending for the fiscal year beginning 1 April. The proposal points to a substantial budget deficit, and supplementary outlays are likely if economic growth flags. The expected gain of 4% - 4-1/2% in real GNP will be insufficient, however, to prevent a rise in the already high rate of unemployment. Unemployment probably will edge up to a little more than 6%, compared with last year's average of 5.6%.

Demand, Capacity Limitations, and Inflation

7. Canadian economic growth is unlikely to be restricted this year by insufficient aggregate demand. Private investment activity promises to be strong, since more industrial capacity obviously is needed and ample funds will be available from domestic and US sources. A 46% jump is planned in manufacturing investment, according to the latest government survey. Particularly large outlays have been scheduled in the steel, chemical, and paper and pulp industries.

8. Consumer demand also should remain strong because Canadians generally do not have the worries about energy problems, a pronounced economic downturn, and domestic political affairs – problems that are inducing caution in other developed countries. Canada, for example, does not face contractionary repercussions from a huge rise in oil import costs this year. Strong as domestic demand promises to be, a sharp decline from last year's 7% gain in GNP seems unavoidable because of industrial capacity constraints and weakening export demand.

9. Ottawa's expected effort to maximize economic growth almost certainly means a rise in inflation beyond last year's 9% rate. Even though food prices may level off, pressure on raw material supplies and manufacturing capacity will push up many other prices. Prices of petroleum products will rise in April, when the government's seven-month freeze expires. Finally, labor unions can be expected to press for wage hikes of at least 10%-11%, which will increase unit labor costs substantially. Although talk of wage-price controls continues, Ottawa is unlikely to take such action.

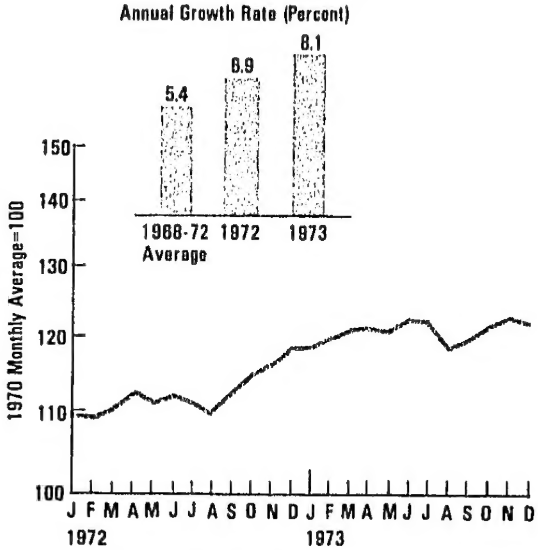
Weakening External Accounts

10. Strong import growth and sluggish export expansion point to a 1974 trade surplus only half as large as last year's $1.9 billion. Export growth, expected to drop even before the oil crisis, is expected to slip to about one-third of the 25% gain in earnings achieved last year. Soft foreign demand will limit the growth of sales volumes and prices of most raw materials and manufactures. Even though oil exports to the United States will be cut by diversion of output to eastern Canada, higher prices for oil will result in a doubling of earnings over 1973.

11. Canada's current account deficit is likely to exceed net long-term capital inflows – expected to reach $800 million to $1 billion in 1974 – but the Canadian dollar is expected to remain strong. Since the first of the year, it has appreciated about 3% against the US dollar, as declining US interest rates induced short-term capital flows into Canada. It is unclear whether Canadian monetary authorities will move soon to lower domestic interest rates and remove the incentive for these flows. Even if a net outflow of short-term capital develops, we anticipate that Canada will incur only a small balance-of-payments deficit this year. With international reserves amounting to $6.2 billion at the end of February, Ottawa should be able to handle such a deficit without strain.

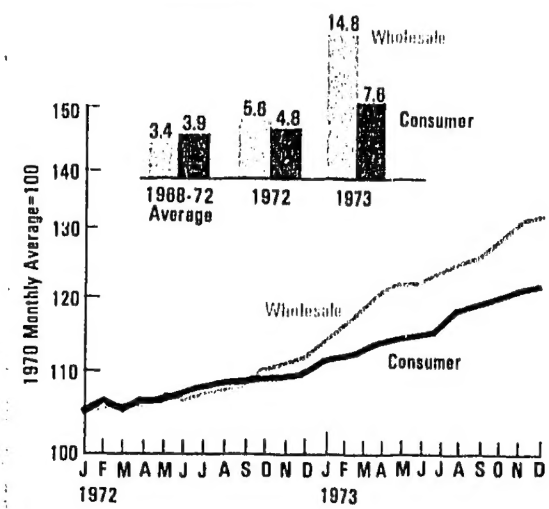
CANADA: INTERNAL ECONOMIC INDICATORS

INDUSTRIAL PRODUCTION*

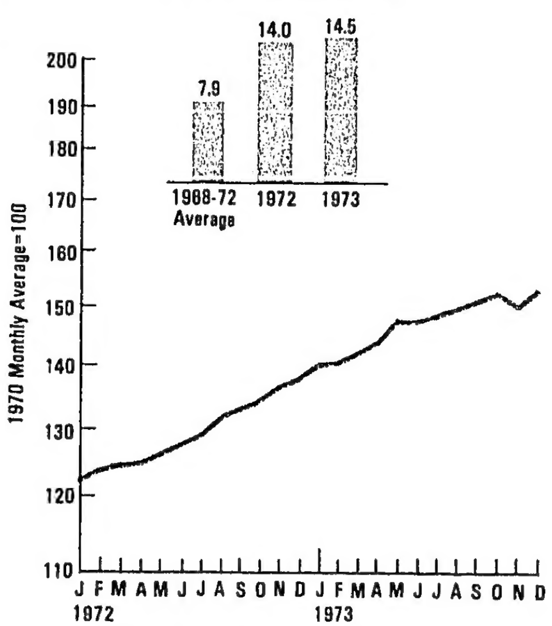


*Seasonally Adjusted

PRICES



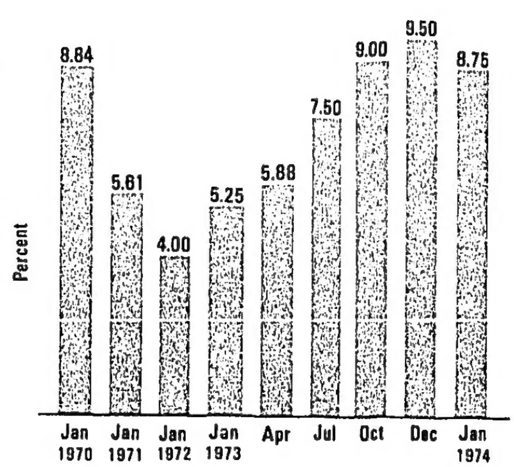
MONEY SUPPLY*



*Seasonally Adjusted

MONEY MARKET RATES

Interest Rate for Finance Paper



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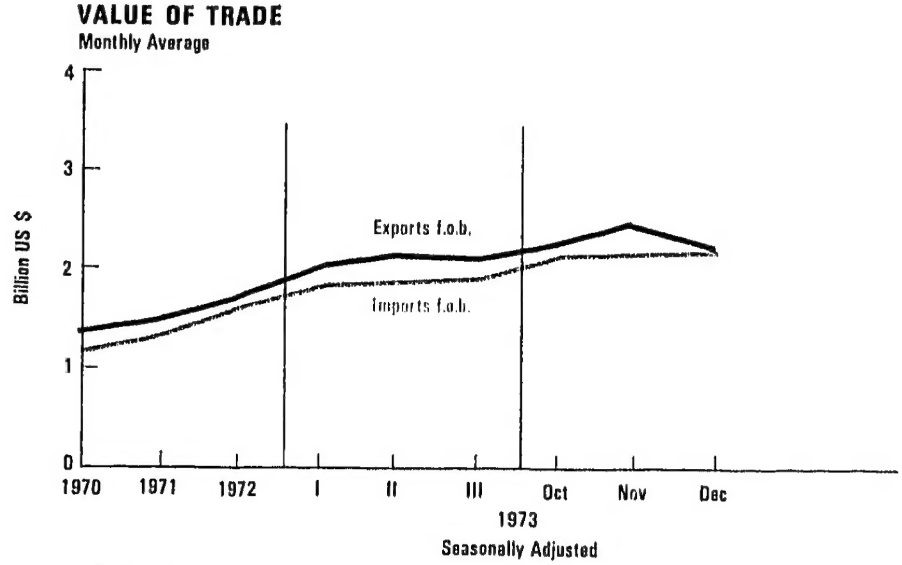
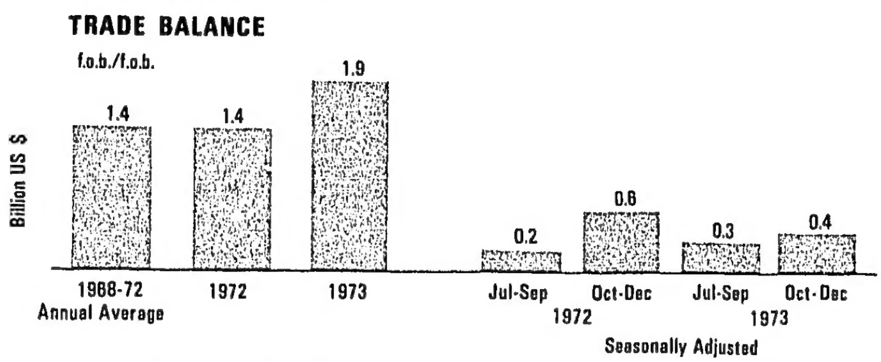
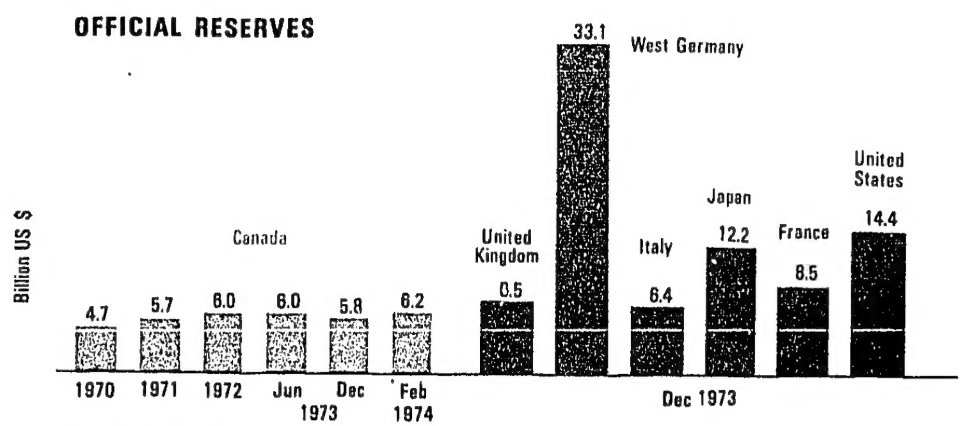
CANADA: EXTERNAL ECONOMIC INDICATORS







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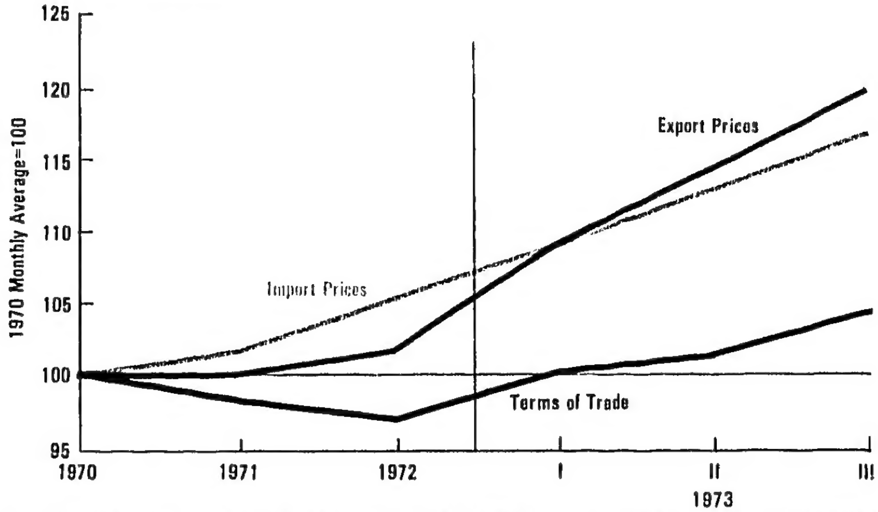
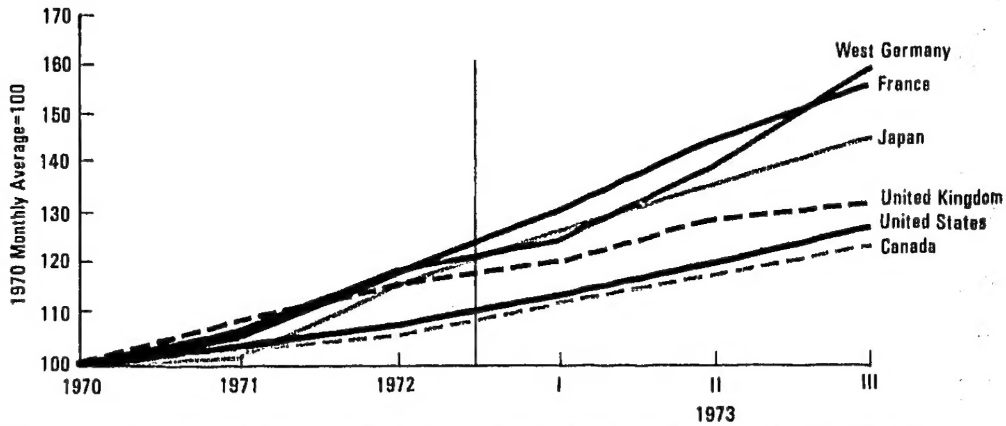
CANADA: EXTERNAL ECONOMIC INDICATORS

TERMS OF TRADE

National Currency

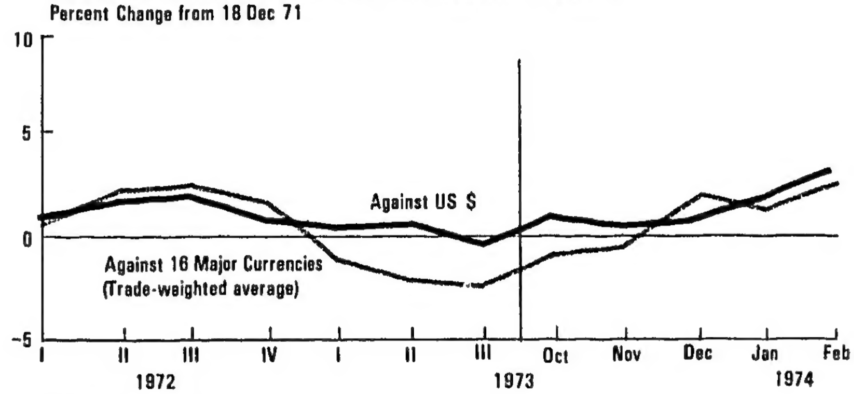


EXPORT PRICES IN US $



EXCHANGE RATES FOR THE CANADIAN DOLLAR

Percent Change from 18 Dec 71



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